DFI SPY for CREDIT UNION$

Winter 2001

KENTUCKY DEPARTMENT OF FINANCIAL INSTITUTIONS

Regulatory News for Kentucky's State-chartered Credit Unions

Welcome to the second annual newsletter by the Department of Financial Institutions that is devoted entirely to credit unions. The objective of our newsletter is to improve communication between the Department and the credit unions we regulate. We hope you find this newsletter educational, beneficial, and enjoyable. Feedback from the industry is important to us and we would like to hear from you.

Unclaimed Property Act KRS 393

It appears there is some confusion of when an item becomes escheatable per KRS 393. An item is presumed abandoned after seven (7) years from the date of last activity. Activity does not mean an interest credit, automatic renewal, or regular charge or fee. Activity consists of owner activation either in writing or action. This includes deposits, withdrawals, inquiries, or changes to the account. These can be in person, or in writing. Receiving a regularly mailed statement constitutes account activity if it is of a type sent to all account owners in this category and is mailed no less than annually. If the statement is returned by the United States Postal Service marked undeliverable, the seven-year period is not affected. Credit unions do not have many accounts that become dormant enough to be escheatable. Simple procedures for compliance can be undertaken.

An accurate dormant account report should be generated. The report should include the date of the last member-initiated activity and the last interest date. These are two distinct dates per KRS 393. This report should be maintained for examiner review.

Management is encouraged to prepare a short notice to be signed and returned, in a credit union provided envelope, stating the owners are aware of the account and want to maintain the account at the credit union. As the seven-year period gets close, mail these statements to each affected account holder, and retain responses for proof of contact. All written responses should be included as an account activity date, thereby removing the account from the dormant report. The written acknowledgements returned as undeliverable should be grouped with prior returned account statements for easier review of escheatable dates.

Dormant account fees can be imposed upon these accounts if the fee was disclosed on the initial account agreement, the truth in savings disclosure, or in writing at least 30 days before imposition. This should alleviate all smaller dormant accounts from reportable status.

INSIDE

Printed with State Funds

Call Report Information Overlooked

Page 8, line 11 of the Call Report asks for the "Amount of Real Estate Loans Outstanding that will contractually refinance, reprice or mature within the next 5 years and that are not member business loans". This area is often left blank or an amount is reported that is less than the total adjustable rate loans at the credit union.

Mergers

The Department has approved the following mergers:

- August 2001 Dixie Cup Credit Union merged into GTKY Credit Union
- November 2001 Progress Credit Union merged into L&N Federal Credit Union

Legal Ease

Loan Participations

The Department has agreed to consider any request by a credit union to engage in the practice of loan participations. The position is based in large part on the fact that Federal Credit Unions (Rule 701.22) are permitted to participate in such transactions. KRS 290.075(8) states that a credit union has the power to:

> Discount or sell any of its ***assets***, and purchase the ***assets*** of another credit union, subject to the approval of the commissioner. Emphasis supplied.

Loans would be considered to be assets of a credit union. This provision could be construed to allow Loan Participations. However, the participation transaction is by application and the mere act of applying does not guarantee that the application will be granted.

Out-Of-State Credit Unions

The Department has taken the position that an out of state credit union may not seek to expand its field of membership around its Kentucky branch. A Field of Membership expansion requires approval from the state in which the credit union is chartered (or the National Credit Union Administration for federal charters). KRS 290.065 only allows an out-of state credit union to conduct business in this state if it is needed to adequately serve the members located in Kentucky. An out-of-state credit union will not be allowed to seek to expand its field of membership from the Kentucky DFI. Such expansion can only come from the home regulator.

Copies of Bylaws

The Department takes the position that a member of a credit union is entitled to a copy of the credit union's bylaws. The member can seek a copy from the credit union itself or by writing and asking the Department for a copy under the Open Records Act.

Joint Signatories to Account

A member may have a non-member joined as a signatory to an account in a credit union. The non-member may even go so far as to guarantee a loan (as co-maker). However, only the member can vote in credit union meetings and elections. Notwithstanding any extra rights held by the non-member, the non-member is not a member and does not have the full rights of a member.

Definition of "Immediate Family"

Whenever the words, "immediate family," are used in connection with, or to define, fields of membership, such words shall only include a spouse, child, sibling, parent, grandparent, grandchild, stepchild, stepparent, and adopted children of the member. The term, "immediate family," shall not be expanded beyond those groups without an approved Bylaw Amendment from the Department.

IMPORTANT REMINDERS

1) The Kentucky Department of Insurance requires any employee of a credit union to be licensed if the employee is involved in collecting or holding premiums in any manner, explaining coverages or benefits to insureds or prospective insureds, quoting rates, actively seeking insureds for a particular insurer, or taking and / or filling out applications for insurance.

2) It is possible to obtain the Report of Officials electronically from NCUA's website. The address is www.ncua.gov. Click on Reference Information then select Report of Officials from the list. After clicking on this item, select "Download ROOSETUP.EXE" to install the program. When the install is finished, create the Report of Officials using the enclosed printed instructions. While it is possible to send NCUA an electronic copy, a hard copy must be printed and sent to the Department of Financial Institutions. We are working on a process to also allow for electronic submission. Remember to send in your Report of Officials after your annual meeting.

IS YOUR CREDIT UNION READY FOR E-COMMERCE?

As computer use proliferates, more financial institutions have started offering on-line bill payment systems, electronic statements, home banking, opening accounts, loan applications, and other activities through the Internet.

Although the credit union will be providing new and needed services and possible new products for the membership, it also exposes itself to potential problems by relying on third parties to provide the expertise to develop and support these services. The majority of these services will be provided through service providers either affiliated or more often not affiliated with the institution. It is essential for the Board to establish written policies and procedures prior to initiating these services by planning and controlling the services from their inception.

The Board of Directors should develop written policies and procedures that focus on the inherent risks that are associated with e-commerce. These include:

- Operational/transactional
- Security
- Reputation
- Compliance

The Board of Directors must consider the third party's ability to maintain a secure system. This should include intrusion detection, customer authentication, verification, and authorization.

The Board should craft the policies to ensure that all aspects are reviewed and all risks are considered and covered by the policy and the manner in which the credit union will manage its relationships with each service provider.

The Board, or a committee, of the Board will also have to be responsible for reviewing the following areas for each provider:

- Monitoring their financial condition and operations
- Assess the quality of service and support
- Monitor contract compliance and revision needs, and
- Maintain business resumption contingency plans .

The Board should review the last audited statement of the vendor, its organization, and its responsiveness to its customers and plan an annual review of the audits. The Board should also seek at least two or three vendors for any service to provide cost management through a bid process or an analysis of each offer.

Reviews should be conducted on the levels of service and support on at least a quarterly basis and contractsshould provide for copies of independent internal audits and external audits such as SAS 70 Type I and II reviews. Type I SAS 70 reports review the service provider's policies and procedures while Type II SAS 70 reports provides tests of actual controls against policies and procedures.

The Board of Directors or appointed committee should develop a procedure to ensure its website meets all compliance requirements. These requirements include, but not limited to: insured status, disclosures for savings and loans (the same required in hardcopy advertising), Federal Regulations B, Z, E, Equal Housing, HMDA, TISA and any other applicable regulations required for advertising. Failure to meet disclosure requirements provides unnecessary exposure of the credit union to lawsuits, civil, and criminal penalties.

The Board, or its committee, should ensure that the written contracts with vendors include performance standards and specific remedies that address the failure of the third party to meet the standards. The contract should establish the internal controls that are to be maintained by the service provider.

The Board must scrutinize these services carefully prior to and after implementation. This scrutiny is to ensure strong relationships with the members and properly reflect the commitment of the Board to provide new and innovative services to the membership, while maintaining privacy and security of the member and the credit union.

HAVE SOME CREDIT UNIONS LOST THEIR FOCUS?

A credit union's purpose is to encourage thrift among its members, provide credit at a fair and reasonable rate of interest, and provide an opportunity for its members to improve their economic and social condition. This is the definition according to KRS 290.005. Credit unions exist solely to serve their members. Does your credit union still fit the definition?

Credit unions were once known for their motto, "not for profit, not for charity, but for service". There should be a world of difference in the quality of service and attitude you provide to your members.

The slogan "people helping people" summed up what a credit union was all about. However, this is a slogan you rarely hear anything about these days. Is it not used anymore because credit union management has changed their mentality? Every day more banker mentality is applied to credit unions. The other day a friend of mine made the comment, and I quote, "**I do my banking with my credit union**". In my opinion, the words bank and credit union are not synonymous. If your members can't tell the difference, then you are doing something wrong. Credit unions are not for profit because income is to be returned to members in the form of higher dividends, lower loan rates, and lower fees. By performing this function, banks are pressured to lower their loan rates and fees, and pay higher rates on savings accounts. This provides benefits to all consumers. So the next time earnings need a little boosting, look first at operating expenses instead of dividend rates, fee income, and loan rates. And, how does risk based lending fit the philosophy of "people helping people", when the member in most need is charged a higher rate of interest than his fellow member?

The common bond, originally and for decades thereafter was limited. However, in recent years has been interpreted very liberally. This has allowed numerous credit unions to greatly expand their field of membership. Is this expansion really for the benefit of the members or is it more of an ego boost for management? I strongly believe that every citizen should have access to a credit union and I also believe that diversification is necessary in order for some credit unions to survive. However, I also believe that credit unions should ensure that the current field of membership is adequately served before they consider expansion. If your total membership to potential membership is less than 70%, concentration should be upon obtaining membership from the current field before expanding into new fields. Where have the credit unions of yesteryear gone?

Randy Duncan, Credit Union Branch Manager

This is the opinion of the author and does not express the opinion of the Department.

RULE OF 72 INVESTMENT REFRESHER TIP

The Rule of 72 is a useful tool for calculating how long it takes to double your money at a given interest rate if you reinvest the earnings. The formula is: 72 divided by the Percentage Rate of Return = The Number of Years Needed to Double Your Money. For example, if you had invested $1,000, it would take nine years at 8% interest rate for the money to reach $2,000. (72 / 8 = 9)

EMERGING CONCERNS

As of June 30, 2001, 22% of state-chartered credit unions experienced share growth in excess of 15%. This influx of shares is also noted on a national level. Management should exercise caution over purchasing long-term investments with these potentially volatile shares.

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